RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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June 27 DJIA 1885.26; PTI 2310; A-D Ratio -5.91

THE MARKET: Let's start with a few happy facts: On June 25 my Primary Trend Index rose to 2302, a brand new bull market high. As I have stated repeatedly, the stock market DOESN'T GO DOWN when my PTI is making successive new record highs! Next, on June 25 the S&P 500, the NYSE Composite Index, the NASDAQ, The Wilshire 5,000, and the AMEX indices all closed at new bull market highs. Let's face it -- that isn't bear market action. So if you have any doubts about whether we're in a primary bull market or not, put those doubts aside. This is the real McCoy!

In the last Letter I stressed the importance of "reading" the Averages, an art which seems largely lost today. I don't know why so few analysts and market "experts" fail to understand what the market is saying or even how it's saying it, but maybe there are just too many "experts" around today trying to make things complex and esoteric. I really don't know, but I do know this: the REAL STORY is not in the scenarios or projections of Wall Street's gurus or its big-name economists. The real story resides in the stock market barometer (and by that I mean the Averages). It simply remains for us to read the Averages with some degree of correctness!

Please study the chart of the D-J Averages below. It is obvious on the chart that the Transportation Average has been the weak sister in that it has established a series of declining tops and declining bottoms. So isn't that bearish? The answer is "No, not so far." And for the reason why it's not bearish, we turn to classic Dow Theory. As far as Dow Theory is concerned, A MOVEMENT BY ONE AVERAGE, UNCONFIRMED BY THE OTHER, IS MEANINGLESS FOR PREDICTION PURPOSES, AND MORE LIKELY THAN NOT -- DECEPTIVE. This is one of the most basic and most important concepts of Dow Theory, and one that should never be forgotten or ignored.

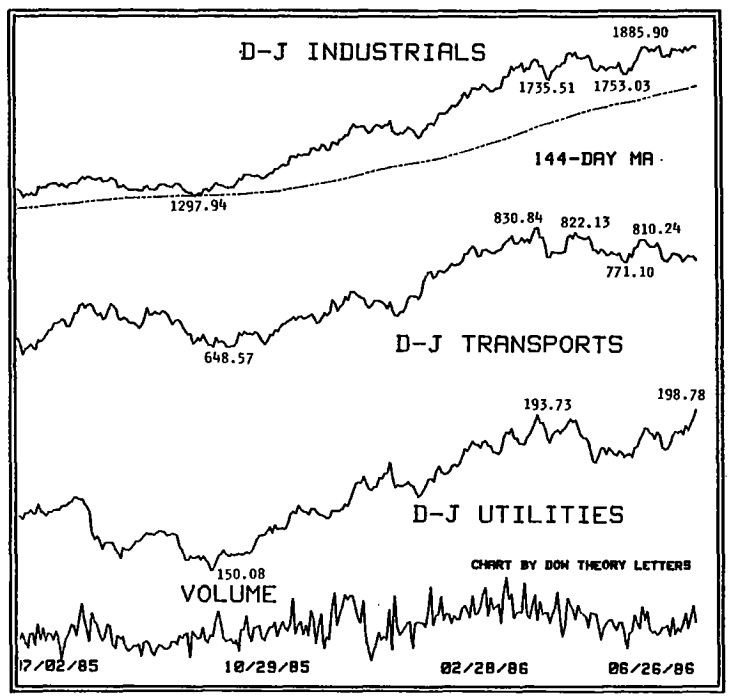
Studying the page 1 chart once again, note that despite the weakness in the Tranports, the Dow itself consistently REFUSED to confirm on the downside. We had the April 7 Dow low of 1735.51. Next, despite further Transport weakness in May we had the HIGHER Dow low point of 1753.03 recorded on May 27. Then more recently with the Transports still weak we saw the Dow gathering strength and running up well over the 1800 level. By June 25, the Dow was within a fraction of its all-time high. But, as almost every analyst in the nation pointed out, even if we get a new record Dow high, the Transports will not have confirmed.

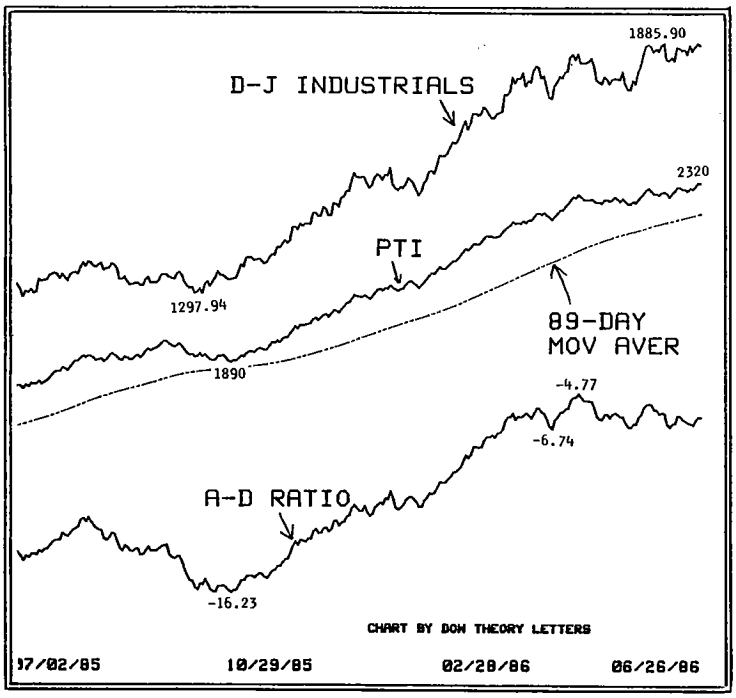
True, true enough. But let me put it this way. I don't care where the Transports go! They can swoon to 600 or 500 for all I care -- AS LONG AS THE INDUSTRIAL AVERAGE CONTINUES TO ACT STRONG AND AS LONG AS THE INDUSTRIAL AVERAGE REFUSES TO CONFIRM ON THE DOWNSIDE! In fact, I feel the market is really putting on a good performance here in that it is stalling, backing-and-filling, hesitating, and in general "taking it easy" after its big early 1986 run-up. As I have said repeatedly in recent Letters, the MARKET HAS MOVED AHEAD OF ITSELF here in mid-1986, and it is in need of a rest. The uncertainty of a series of non-confirmations is providing that rest -- even though the picture to the average person seems to be one of aimlessness, weakness and confusion (remember, at over 1800 the Dow is still better than 250 points ABOVE its 200-day moving average). And that means that the market is still extended and under a certain amount of strain.

You know, it's a funny thing but the great majority of advisory services have been issuing all kinds of warnings about this market over the past few months. The fact is that they have taken a bearish or at least a very cautious position. Because of this I get the feeling that most advisors now want (or really need) a correction or a bear market this summer or fall. They need to justify their bearish stances. Now I don't know whether the market is going to oblige all these cautious or bearish advisors, but my own inclination is to be pretty skeptical of the bear side of this market. You and I know the old adage: The stock market will do whatever it has to -- to drive the greatest number of investors up the wall. And of course, that includes investment advisors as well! Yeah, over the years I've seen many an advisor climb the wall too (and yours truly is no exception).

Here's another observation: Note that the Utility Average has been carving out a series of higher bottoms and higher highs. Although the Utility Average plays no part in Dow Theory, the rising Utility Average is a DEFINITE PLUS in today's stock market picture. In fact, the Utility Average often acts as a bellwether, leading the other Averages in the direction of the primary trend. Few people realize it, but on June 18, June 19, and again on June 25 both the S&P Utility Average and the NYSE Utility Index recorded new bull market HIGHS. I consider this action to be very positive for the stock market.

Another observation: We hear a lot about the foreign debts (particularly the Mexican debt) and the shaky position of the US banks. But all this is WELL-KNOWN by the market. Personally, I prefer to watch the NYSE Financial Index (containing ALL the financially-oriented NYSE stocks from banks to savings & loans, from brokers to small loan companies), and this index is now at

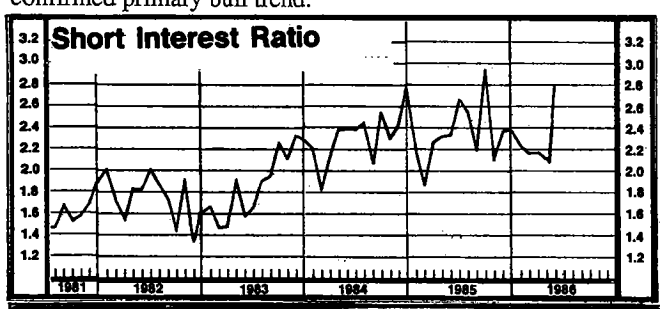


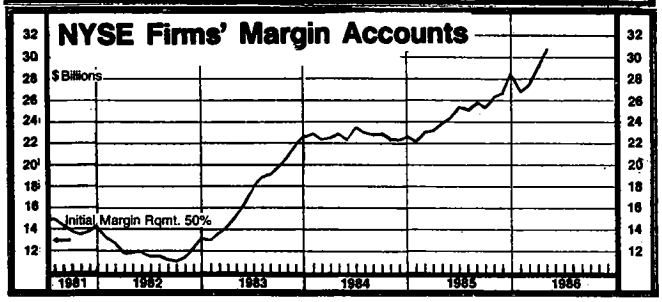


roughly 155, just 4.5 points below its record high of 159.45. Evidently, the Financial Index doesn't see Armageddon around the corner -- yet!

So, I want to say once again that this is still a CONFIRMED PRIMARY BULL MARKET. And in a bull market we give the bull every benefit of the doubt. For instance, if the Industrial Average (during a bull market) is advancing and the Transportation Average is declining (as is the case today), we assume that the price structure remains bullish, because we assume that the Industrials are on the correct path, and it is the Transports that are traveling the wrong road. Obviously, our assumption would be exactly the reverse if the primary trend were bearish.

Here are two charts (courtesy of Media General Financial Weekly) that I feel are worth including. The first shows the latest (May-June) short interest ratio figure for the NYSE, and it's a whopping 2.81. This is the second highest short interest ratio figure since the 1930s, and it's only exceeded by the 2.95 reading of last September. I don't care how much arbitrage we're seeing, this 2.81 is one super-high level. It is telling us that there are just TOO MANY people on the short side of this bull market. And there is nothing more bullish than rising skepticism in the face of a confirmed primary bull trend.





The second chart shows the margin account totals for firms on the NYSE. Historically, margins rise or fall in the direction of the primary trend. And new highs in the margin accounts during a bull market are bullish. When a bear market finally does arrive, we'll see the margin totals drop and drop until the last margin speculator is pressed against the wall and finally sold out. Right now, the opposite is true.

Interesting facts: Five Dow stocks account for 52% of the Dow Industrial Average weighting. Here they are: Telephone at 6.23%, Exxon at 10.39%, GE at 8.78%, GM at 5.84% and IBM at 21.68%. Obviously, IBM is the biggie. But over the last YEAR the big winners in terms of profits have been Philip Morris up 56%, Woolworth up 51%, Merck up 47%, Int. Paper up 27%, Amer. Can up 26.7%. Over the last FIVE years the winners have been Woolworth up 403%, Westinghouse up 324%, McDonalds up 250%, Sears up193% and GE up 185%. Over the last 13 weeks the winners have been Woolworth, Merck, Union Carbide, Philip Morris, Owens-Illinois.

Incidentally, I've always been of the opinion that you could make all the money you wanted just by being in the right (strongest) Dow stocks, and I think the figures above prove that. I also believe that the same theory holds for the future. The Dow type stocks are usually the safest stocks and usually the LAST to top out at the end of a bull market. The big blue chips don't hit spear-point tops and then crash the way the junk stocks do; instead, they tend to form extended distributive tops and then roll over and come down. Thus, the owner of the blue-chip stocks has a better chance of getting out near the highs when a bear market finally takes over.

TODAY there are eight Dow Industrial stocks that are still acting outstanding: Amer. Express, DuPont, McDonalds, Merck, Owens-Illinois, Philip Morris, Westinghouse, Woolworth.

INVESTMENT POSITION: The bull remains in this box. It's still a primary bull market. But ponder this: I have been saying it periodically, and I might as well say it again. This market has in many ways been turned into a giant gambling casino. We've got options, futures, switch techniques, a new fund every day, arbitrage programs, you name it. The boys on Wall Street have turned a number of segments of the stock market into the counterpart of the commodity game. You don't take delivery of your favorite stock anymore; no, you just place a bet on whether that stock is going to go up or down!

Frankly, it's OK with me. Let 'em speculate. All the options and futures-bets in the world aren't going to change the direction of the primary trend. And it's the primary trend of the market that I INVEST WITH. But I do know this. The market has its own method of dealing with fads -- particularly big speculative fads. That method is called "wipe out." Yes, the wipe out can be fast, as in a severe correction, or it can be slow, as in the old "Chinese water torture." My own guess is that this market (and I've been saying this for some time) is in for a period of water torture or a slow trading range-type correction.

Today everybody and his brother is pointing to the divergences and non-confirmations in the various averages and indicators. And because EVERYBODY sees these discrepancies, I feel their importance is diluted. But the divergences and technical problems will bring the market to rest or into a trading range. It'll be a trading range calculated to frustrate the bulls and drive the bears up the wall.

So who will be the winners in the coming months? My bet? Those patient investors who own stocks and bonds and who are sitting with those stocks and bonds and collecting the interest and dividends on those stocks and bonds. This has been a "buy 'em and hold 'em" market all along, and I think it's going to continue that way. In a big bull market you buy stocks and let the PRIMARY BULL FORCES WORK FOR YOU. That's where the

REAL MONEY is made. If you've been buying and holding stocks and bonds in this market, you already know what I'm talking about. If you've got your mind set on trading in-and-out in this market -- good luck.

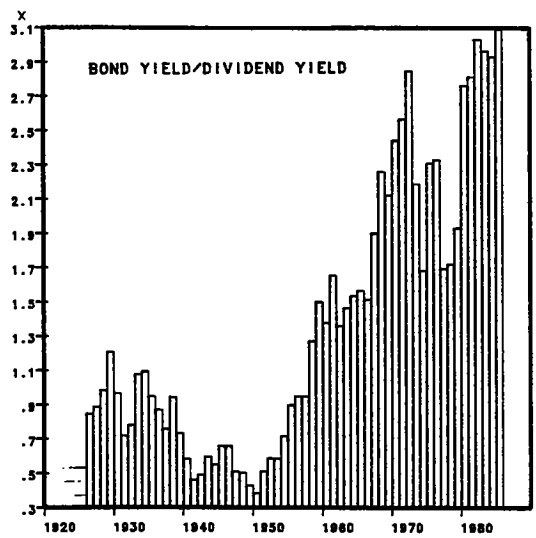
MORE RUSSELL'S BIG PICTURE: In Letter 939 I included a piece in which I posed the possibility of a long period in which the market worked itself generally higher. This happy projection was based partly on contrary opinion, partly on my own intuition, and partly on the fact that the A-D ratio (see charts in Letter 939) had broken out of a long, nine-year sideway consolidation.

My scenario also included the thesis that the US (and maybe much of the civilized world) is facing a new (since 1942) phenomenon. That phenomenon is the gradual rundown of debt, debt which has been accumulated by the carload ever since World War II.

In the US alone the debt (of all varieties including public, private and corporate) is now roughly $8 trillion. The cost of servicing this incredible mountain of debt is now exerting a decidedly DEFLATIONARY FORCE on the US and world economies. This deflationary force catches the US in an embarrassing and awkward position. Deflation has entered the picture at a time when the average US citizen is borrowed up and ironically positioned for more inflation.

In view of this, the trick (and Mr. Volcker is obviously aware of this) as I see it is to keep America off the inflation bandwagon, but at the same time to keep America from sliding into a depression. It is not going to be an easy job. And even if we do avoid both inflation and depression, the process of reliquefying is going to be lengthy, tedious and painful. But I don't think it is impossible. And remember this: If this nation can run down its debt, if it can reliquefy, such action will constitute a huge contrary opinion. It will serve to frustrate both the super bulls and the super bears. Suppose in the next 10 years the Dow fluctuates between, say, 1500 and 2500. That would leave a fairly frustrated gang of investors on Wall Street and Main Street. They'd be frustrated because 2500 wouldn't be enough for the bulls and 1500 wouldn't be low enough for the bears. And that's what the market is best at — leaving the greatest number of investors frustrated, angry and gnashing their teeth.

If the picture I have outlined above does come to pass, what do we as investors do? I would say (1) diversify, (2) stay solvent, (3) keep an open mind, (4) understand that we are moving into a major new era of reliquefication, debt run-off and deflation, (5) realize that the operative word for the late-1980s and 1990s is going to be INCOME. Income is how you keep your standard of living up. Income is what you need to keep your families in shoes, food and shelter. And income is going to be increasingly elusive in the years ahead.



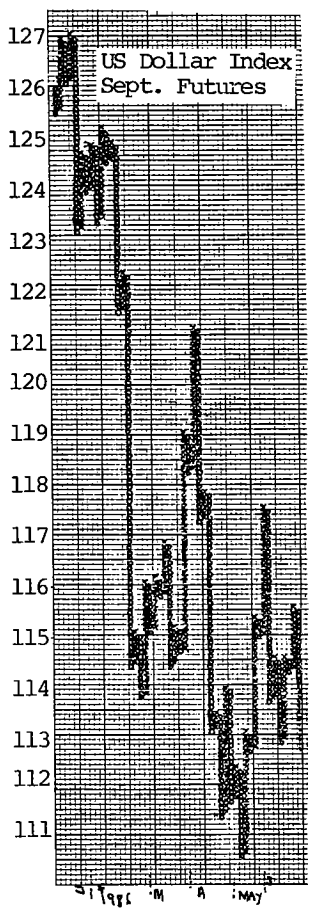
Along these lines, I am reproducing here a chart from the latest Merrill Lynch "Investment Strategy Quarterly" (and I might as well say that I have found this quarterly to be one of the best in the industry). This chart shows bond yields (annually) divided by stock dividend yields. And to my mind, this is one of the most basic and enlightening charts that you will find anywhere. Why? Because this chart tells a story that cannot be ignored. The chart deals with a critical item — the relationship of the INCOME from the two principal financial investments, stocks and bonds.

Note that all through the 1930s until 1950 the trend was for stock income to be more attractive than bond income. During that period stock yields were above bond yields, but as I well remember, during that period everyone was still thinking of 1929 and the Great Depression -- and they just didn't trust stocks. So bonds were preferred, regardless of the fact that stocks offered much better yields.

From 1950 until today that thinking and that equation has changed. The trend was steadily toward stocks and away from bonds, and finally we see the ratio of bond yields to stock yields at a new high--better than 3 to 1 in favor of bond income. But remember—this trend was based to a large extent on two concepts: (1) stock earnings were going up, while bonds were not, and (2) stocks could adjust for inflation while bonds could not. For this reason, many cynics termed bonds "instruments of guaranteed confiscation." But I want to remind my subscribers: that has been the thinking of the PAST 35 years. THE TIMES, THEY ARE A'CHANGIN'.

At this point, I think one can make a good case for the emergence of HIGH QUALITY BONDS as a must in any diversified portfolio. Bonds are where the fat income is. Bonds -- high quality bonds -- are going to continue to provide income and help you keep up that standard of living in the tough years ahead. Bonds, in fact, should probably represent the foundation of an individual's portfolio over coming years. This is my thinking right now, and although I own common stocks, I buy them only with the income that is generated from my bonds.

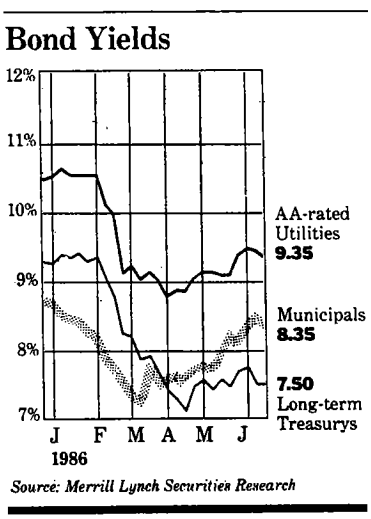
TRENDS, CHARTS: From every quarter we hear predictions of a lower dollar. Maybe so, but here's my chart of the dollar index (which is heavily weighted for the D-mark and the yen), and I must say that it looks as though the dollar might have bottomed in May. Actually, I'd want to see 110 on the dollar index before I'd be willing to say that the dollar is still in a downtrend. At 118 on this index, I would state that the dollar was turning strong again. As I said, this chart looks "bottomy" to me.

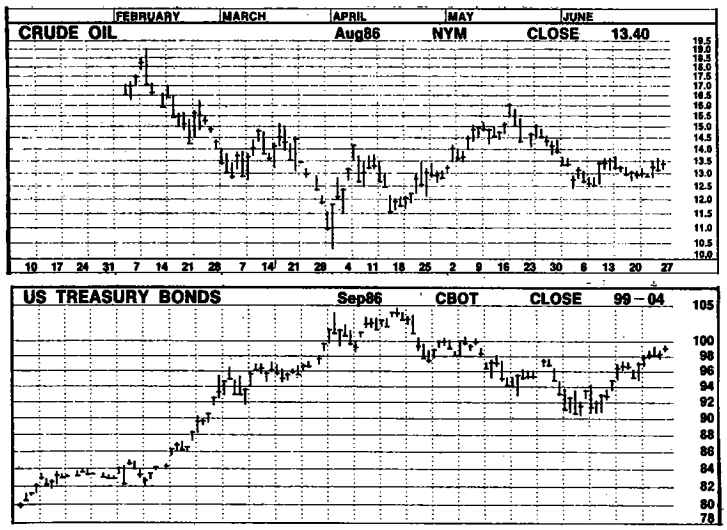


Next case. This chart of the T-bonds (Sept. contract) shows the 13.5% drop in the bonds from 104 down to just above 90. But since then, the bonds have rallied well, having recovered better than half their losses. If the September contract can get back over 100, it's a good bet that the bonds will try for their April highs again. The muni bonds were hit harder than most other bonds due to confusion over tax issues. I include here a chart showing an extraordinary situation -- the tax-free muni yields in June going OVER the taxable long-term T-bond yields.

Even so, tax-exempts yielding MORE than taxables? Sounds like bargain time for people who don't love taxes.

Crude oil: The chart suggests to me that oil is (like so many other items) in a trading range. The panic lows of early-April could be tested again -- but I doubt that they will (I'm an optimist). On the upside, the target for the August contract is 16. I'm betting on a trading range (actually, aside from a position in Exxon, I'm not betting on oil at all).





Question: I've been reading all sorts of articles comparing 1986 and 1987 to 1928 and 1929. Do you think the comparisons are valid?

Answer: Every once in a while the newspapers or Wall Street or some other street get a big new concept in their heads. Then it seems to sweep the nation like wildfire. This year's concept is that we are in a carbon-copy disaster scenario that can only be compared with 1929. Why are people thinking this way? For one thing, we have been witnessing record volume on Wall Street. For another, the Dow has finally broken out of its 17-year trading range (1966 to 1983), and the Dow is now nearly double its old 1,000 ceiling. This reminds many people of the final explosion during 1928 and 1929 when the Dow reached the unheard of height of 381. That 381 level was better than double the highest prices seen only four years earlier in 1925. It's the "Gad, I've seen this before" syndrome. And finally, people read about today's horrendous debt situation, the problems with the undeveloped nations' loans, the arms build-up, the lack of competitiveness in American businesses. All in all, there is a sense of foreboding, and it seems to be expressed in the concept that "this is 1929 all over again."

In my studies of the stock market I note that history almost never repeats in the way people expect. What everyone worries about seldom happens. No, the unexpected is what usually occurs. My own humble guess is that the 1929 syndrome is going to be put to rest during the next couple of years. And then, instead of a 1929 repeat, we will be treated to some other kind of mess -- maybe a long, frustrating trading range or a long, drawn out eroding bear market. But I doubt if we are going to see 1929's twin in the years ahead. Unless (possibly) people turn all-out, crazy-bullish and the very notion of 1929 is totally forgotten.

Question: Russell, you've written for two years about the water utilities and the coming water crisis. Do you still believe in both?

Answer: You bet I do. In a recent issue of "People" magazine (of all places), there was an excellent and ominous interview with expert Charles Bowden on water. Bowden states that America's water binge is about over, and that we're now using more water than we have. He talks about the rapid depletion of the great Ogallala underground reserve and the dire situation in the Southwest. At any rate, it's increasingly obvious to me that we're moving into the era of water crisis -- a situation where the price of water is going to be accelerating upward on a supply-demand basis. In a matter of a few years, people in the West are going to be learning about desert plantings rather than the latest hybrid grasses (there's an idea for a thousand new businesses, by the way).

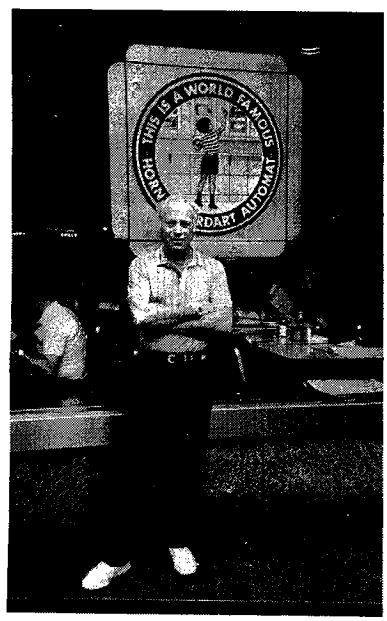
As far as the water stocks are concerned, there are only 16 listed water companies. I like most of them and I've been recommending most of them. Here are a few that I like now: American Water Works (the biggest and listed on the NYSE) along with United Water Resources, which I also like; Consumers Water (OTC); Philadelphia Suburban (NYSE); E'Town Corp (formerly Elizabethtown Water Co. (OTC)), and California Water Service (OTC).

Question: There's been an awful lot of insider selling recently. Isn't that bearish for the market?

Answer: I've been a bit skeptical of the whole insider selling concept -- mainly because I've never been convinced that insiders know very much about the stock market or the direction in which their own stock is heading. Yeah, I know the history of the insider selling and buying indices -- but the whole study has been getting too much attention and too much credence of late.

Interestingly, I just received a letter from the treasurer of a major (over a billion in sales) retail chain. He too is skeptical of insider transactions and writes: "What price are the insiders buying at? Often insiders are buying at option prices that are substantially below market. Their decision to buy may be related to a plan to sell six months later. Hence, a totally false conclusion is arrived at by reading their buys as bullish for the stock.

"How much stock is left after an insider sells? In other words, is it really significant when an executive sells 20,000 shares and has 3 million left?" Interesting comments, eh?



MEMORIES: When Faye and I went to New York last May, one of the first things I wanted to show Faye (who's a California girl) was one of the favorite spots of my childhood, the Automat. During the Depression and right through to the 1940s the Horn and Hardart Automats were some of the landmark restaurants of NYC and Philadelphia. The Automats consisted of help-yourself walls of little metal boxes. There were sections for sandwiches, hot foods, desserts, etc. You could see the food through the glass walls of the box, and the price of each item was marked in nickels and quarters. Pies were 15 to 25 cents, sandwiches ran 20 to 45 cents, the famous hot beans were 15 cents, and the coffee was a nickel.

All the kids loved the automat. We loved the slots, we loved the food and we loved the big variety. And many a working man and woman found the Automat a welcome haven from the snow or the heat in NYC. During the Depression I well remember that if you left anything on your plate some down-and-outer would

immediately sit down and finish your food. Thus the Automat probably saved many an American from hunger or even starvation.

Alas, the rising prices and rising expectations of the 1960s wiped out the old Automats. People wanted glamor and service, not bargains. On top of that, it became too expensive to repair all those little window-machines that lined the walls. So now there is but ONE Automat left in NYC, a relic of the past (it's on East 43 Street near Third Avenue). And it's not the clean, wondrous restaurant of my youth, but I won't go into that. Anyway, Faye and I had a cup of coffee at the last surviving Automat, and Faye took this picture of me standing outside the only surviving restaurant. Who knows, when hard times return again (which some day they will), maybe someone else will revive your nickel and quarter marvels.

HEALTH HINTS (Learned the hard way): You think all you get in these Letters is a lot of information about money and investments? Forget it! I write about the quality of life too. Among my fondest dreams is to keep ALL my subscribers not only prosperous but healthy. "Aw, Russell," you complain, "what are you bugging us for? Just stick to the market, and we'll take care of our own heath!" Indulge me, dear readers, my little side journey will only take a few minutes.

Two of the things you can do for yourself is cut back on (1) stress and (2) bad food. Believe me, I'm an "amateur-expert" on both, having eaten the wrong kind of food for the first half of my life and been a stressful type for the first 50 years. But I'm also a learner. I may learn the hard way, but I learn. I've written before about stress (and I will again) but now I want to write about food. You know, it's only been recently that we have learned about stress and diet. For instance, my father died in 1956 at the age of 64 of a heart attack. At that time they didn't know much about hearts, diet, stress or what to do about them. Times have changed -- and I mean they have CHANGED A LOT.

Of the 10 leading causes of death in the US, not less than SIX are now connected with diet. These are heart disease, stroke, cancer, adult–onset diabetes, artherosclerosis, and cirrhosis of the liver. Quite a group, eh? And none of them any fun.

Americans eat the richest foods, the "most fun" delicious foods, and in general boast probably the worst diet of any nation in the world. We eat too much sugar, too many processed foods, too much salt and far too many fats. As a result our blood cholesterol level tends to be far too high. One in maybe 500 people has a genetic problem with cholesterol, and therefore the cholesterol cannot be lowered except through drugs. The other 499 have no excuse.

The "normal" cholesterol range in the US runs about 220 to 280. If you have a cholesterol level of say 200 to 220,your doc will probably say you're in good shape. Maybe so, but in other nations our so-called normal levels would be considered high. In Latin America and in the Orient, the normal range is 150 to 180. In Italy it is 175, in India,146 and in Peru, it is 137. In Japan it used to be low (they were fish and vegetable eaters), but now that Japan is going "American" their cholesterol levels are moving up — and so is their heart attack rate.

Ideally, if we lived on a diet of mostly fish, chicken, vegetables, fruits, and whole grain products with little dairy, meats, confections, sugars, and fats, we'd be in MUCH BETTER SHAPE. The diet–connected diseases in the US would shrink dramatically. But Americans, like most other people, don't go for preventive medicine. They go for treating diseases (although this is beginning to change now).

I don't have the room here to go into a long tirade on what to do and why. Let me simply recommend a terrific book called "Don't Eat Your Heart Out" by Joseph C. Piscatella published in spiral-bound form by Workman Publishing of New York. The book has a forward by Dr. Denton Cooley, surgeon-in-chief of the Texas Heart Institute. This book starts with 176 pages of valuable information, facts, and suggestions. The rest (to page 529) contains recipes and food suggestions. I wish all my subscribers could buy this book. It's intelligent, informative, easy to read and worthwhile in every way. It costs $14.95. And it's a real bargain.

NOTES & QUOTES: Despite hard times in almost half the states in the nation, home prices are heading higher in many states. Here's a list of the highest median prices for existing single-family homes (based on a WSJ tabulation for the first quarter of 1986). If you live in any of these areas, your home is probably worth a lot and going up in value. If you want to move to one of these areas, get your wallet out -- it's not going to be a cheap move!

The cities with the highest median prices for existing single-family homes (first quarter; 1986)

Boston	$149,000
New York (includes Northern N.J. and Long Island)	147,200
San Francisco	143,000*
Orange County, Ca. (includes Anaheim and Santa Anna)	138,000
Los Angeles	120,400
San Diego	110,000
Hartford, Ct.	106,400
Washington, D.C. (includes Northern Virginia and Maryland)	101,100
Dallas-Ft. Worth	93,900
Denver	84,600
Chicago	82,000
Miami-Hialeah	78,500
Minneapolis-St. Paul	76,300
Ft. Lauderdale-Hollywood-Pompano Beach, Fla.	72,300
Providence, R.I.	71,900

*Third quarter, 1985.

Source: National Association of Realtors

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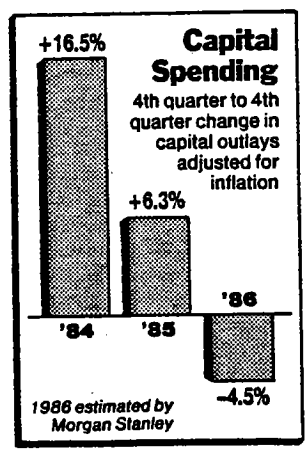
Capital spending is sliding as notes this chart. Furthermore, some are calling the new Senate tax bill a "de-industrialization" in that it kills the investment tax credit. Thus, if the bill is passed it is going to send a lot of capital intensive corporations to the cleaners -- at a time when capital spending needs all the help it can get. Since the new tax bill will encourage consumer spending (and they are already spending their heads off), it's a toss-up how the whole thing is going to come out. In truth, there isn't an economist in the nation who knows how the tax bill will affect the economy -- even in the near-term!



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Oil drilling activity is now at its lowest ebb since the Hughes Tool Co. started tabulating the figures back in 1940. At latest count the drilling rigs in operation were 698. Greatly affected by the slump is mighty Schlumberger (SLB), which was priced over 80 back in 1980. SLB is now down around 32 and many think it's an interesting speculation. The company is in very tough businesses, though, computers and oil drilling. But it has cash and equivalents of $4.6 billion ($15.50 per share), and it apears as if SLB can cover its $1.20 dividend. SLB may be an interesting long-term bet on the great Wall Street bull market lasting and on oil drilling coming back. But if you buy SLB, I would just take a small position and do that with a generous portion of patience.

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Dr. Henry Kaufman has a new book coming out entitled, "Interest Rates, the Markets and the New Financial World." In it he notes that since 1800 there have been five secular (i.e. long-term, fundamental) bull and bear markets in bonds. Since WW II, notes Dr. K., there have been six cyclical bull and bear markets in bonds. Kaufman seems to think that 1981 was a watershed year, and that the cyclical bull and bear markets in bond prices from here on should follow a "level or declining trendline." In other words, Dr. K. seems to feel that the year 1981 saw THE HIGHS for bond yields for years to come. It would be a happy thought if he's right.

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Over the last nine months stock and bond values have added around $600 billion to Americans' wealth. But the problem is that that

increase in wealth has not been widespread. In fact, the figures are rather startling. The good fortune has been concentrated in the top-10% income bracket. Look at these figures: those in the top 10% in income own 92% of all municipal bonds, 85% of all stocks, 80% of all mutual funds and 72% of all non-muni bonds! Unfortunately, the story with debt is not the same. Debt is spread much more evenly throughout the US population, and particularly among the young. In fact, among younger Americans debt is building up faster than assets. As the old song goes, "When will they ever learn?"

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The union movement is struggling to survive today. With heavy-goods manufacturing going overseas (this was the traditional home of the unions), the union ranks are shrinking. The service businesses are now comprising a much larger percentage of GNP, and the service workers are not, and never were, enamored of the unions. Recently, 155,000 workers at mighty AT & T were out on strike, but it wasn't easy for them. With the help of sophisticated automation, 15,000 executives at Telephone filled in. Most customers never even knew a strike was on. The crowning irony is that there is an excellent chance that Telephone's profits actually increased during the strike, since their payroll shrank. The coming question: Can a strike close down a company today? The answer in a lot of cases seems to be NO.

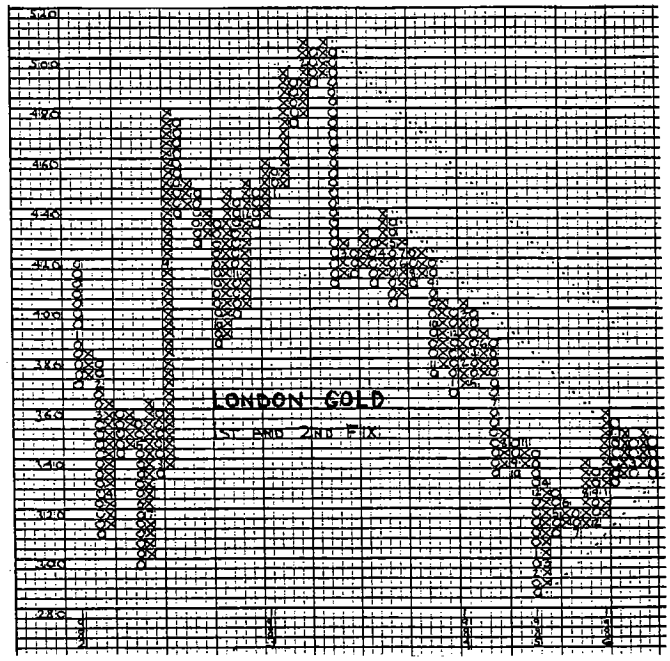
* *

What good are the lower oil prices? Here are some results if oil stabilizes at just $20 per barrel. At $20 the US' oil import bill would drop by $15 billion. Gasoline would come down by 20 cents a gallon. The CPI would drop by 1.5%. Consumer spendable income would rise roughly $30 billion. A decline to an average of $12 per barrel would double all of the above. On the negative side, $12 oil would cost the government about $40 billion in tax receipts (the government has been collecting almost everything over $20 oil in the form of the "windfall profits tax"). Further on the negative side, banks with loans to heavily dependent oil nations would be holding very shaky loans. US oil exports would drop. And oil states such as Texas and Oklahoma would be hit very hard as a prime source of their income caves in.

One of the biggest pluses from low-priced oil is that it is very deflationary. An interesting aside is that Russia receives about 75% of its hard currency from its huge oil exports (Russia is the world's largest oil exporter). The lower price of oil kills Russia's main source of hard money. Thus, look in the period ahead for Russia to be a major borrower of cash in the international markets.

GOLD: I'm not going to say too much about gold in this Letter, mainly because there isn't too much to say about gold. Forget all the little up-and-down daily squiggles for a while. The bigger picture as seen on my point & figure chart tells me that if spot gold hits 332, then we have a rather bearish breakdown for gold -- and a discouraging picture for the gold–philes. But, if gold can rally to the 356-360 area, it starts to look very interesting. At 364, gold scores a big breakout, and it becomes a hot item again.

Gold (and silver), as almost all my readers are aware, tend to do well when inflation is in the saddle. Well, the saddle seems to have fallen off the horse, although many of my friends continue to warn (even guarantee) that inflation will return. But I don't listen to the guarantees, I just watch the markets. The CRB Commodities Futures Index (27 assorted commodities) is only one point off its extreme seven-year low of 202 as this is written. The grains, lumber, cotton, copper, all look awful as do most of the other commodities with the exception of the meats and platinum. And all this rotten price action comes in the face of the Fed's opening the money spigots wide? What's wrong -- where's the inflation? Could it be that the great inflation cycle has crested and is now turning down? I personally think that's what has happened. But let's give the whole thing more time. Where the markets are concerned, we can't hurry the verdict. But if the CRB breaks below its recent low of 202 -- well, just don't bet on inflation, readers, the saddle is still off the horse!



One item (an item which I've reviewed here for years) stops me from becoming very hopeful about gold. That item is the ratio of gold to common stocks (I use the NYSE Composite Index for stocks). Last week that ratio fell to 441, its lowest level in five years. A declining trend in this ratio presents a negative background for gold. When the ultimate gold bull market finally arrives, this ratio will go into a bull market of its own as it climbs higher and higher in favor of gold over common stocks. To put it bluntly, we ain't there yet.

In the face of all the above, I still like gold coins as a diversification medium and as insurance against the unexpected. I've had a lot of subscriber interest in those Chinese 1-ounce Pandas, and as you know by now, the 1982 and '83 Pandas took off in price. But the Chinese government is minting the devil out of the Pandas, so the newer '85s are bought only for gold content. For the '86s it will be the same thing. However, if you want something unusual, ask your dealer about the Singapore gold Tigers, a 1-ounce gold coin. What I heard is that there were only 13,500 of these minted, and I understand they are already selling for about $650.

LATE NOTES: You read the newpapers and you wince. Last week it was reported that the US suffered another whopping trade deficit (even in the face of a weak dollar), and for the first time the traditionally prosperous farm sector was in deficit. Auto sales are nothing to brag about, building starts are down, smokestack America is getting beaten to death -- and well, what do we have to cheer about?

The stock market is marching to a different drummer. Is Wall Street out of its speculative mind? Have the buyers of stocks gone totally daffy? Hardly! Wall Street is now fulfilling its classic function of looking ahead -- discounting the FUTURE rather than wringing its hands over the past. Last week saw the market close with new highs in the broad NYSE Composite, the S&P 500, the S&P 400 Industrial Index, and ALL THREE UTILITY INDICES (Dow, S&P and NYSE). Meanwhile, the Dow Industrials closed within a fraction of their all-time highs.

My PTI is now in all-time high territory at 2320 (see page 2 chart). The PTI has been LEADING this market up all year, telling me and my subscribers that Wall Street is in the grip of a great primary bull market. The stock market is looking ahead, maybe six months to a year ahead, to better times. It's rising (led now by the utilities) because it sees something bullish over the horizon. In closing I would suggest that my subscribers believe the market — not today's pessimistic newsmen and economists.

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